



STATE OF CONNECTICUT

INSURANCE DEPARTMENT

Testimony of the Connecticut Insurance Department

Before the
Insurance and Real Estate Committee

Tuesday, February 10th, 2009

Raised Bill 764--An Act Concerning Derivative Transaction Controls

Raised Bill 764--An Act Concerning Derivative Transaction Control has been introduced at the request of the Connecticut Insurance Department. The Department would like to thank the Committee for introducing this initiative on our behalf. This bill provides the Commissioner of Insurance with the authority to require proof of adequate internal controls over derivative transactions to ensure that insurers can meet their financial obligations to policyholders.

High risk investment activities, coupled with a lack of internal controls to oversee those transactions, can create hazardous financial conditions which have been demonstrated by the recent volatility in the financial markets. To highlight the importance of maintaining those internal controls within an insurance company to guard against these hazards, the Insurance Department's proposal mandates that insurers submit annual proof of adequate internal controls over derivative transactions. Internal Controls are those mechanisms such as how frequently a company reviews its data; cash flow testing; who monitors the transactions and other modeling and forecasting mechanisms. Derivative transactions refer to different types of financial instruments such as futures, options and credit default swaps, among others.

The Insurance Department currently has statutory authority to receive quarterly and annual audited financial statements for each insurer operating in Connecticut to enable the Department to monitor and determine that companies are solvent and can meet their financial obligations to their policyholders. In addition, the Department conducts examinations of all insurers doing business in the state every 3-5 years, or more frequently if needed, during which we assess the company's internal controls over financial matters.

Raised Bill 764 seeks to provide the Commissioner with the explicit authority to require that as part of the annual financial analysis, the company will be required to include a statement from the independent certified public accountant assessing the adequacy of the internal controls relative to derivative transactions. If the assessment is that the internal controls are deficient, the insurer will be required to submit a description of any remedial

actions taken or proposed to correct the action if not already included in the independent accountant's report.

This assessment is mandated to be performed by the Sarbanes Oxley Act and therefore the company will incur no additional expense; we are now simply asking that companies provide that assessment to the Insurance Department to help us discharge our oversight duties more actively.

We note that the bill as drafted, rather than enacting a statute to provide this authority, grants the Department authority to promulgate regulations that would enable us to obtain this information. The Department already has regulation making authority and in fact recently updated these extensive and detailed regulations regarding the filing of audited annual financial statements by fully adopting the NAIC Model Law.

We respectfully request that the Insurance and Real Estate Committee enact a statute to stress the importance of this issue rather than to simply add this as a requirement that deviates from the model and therefore might be overlooked by the carriers. We have attached the language we originally submitted for the Committee's consideration.

Thank you once again, for introducing this concept on our behalf and for your consideration of amending this bill to reflect our original proposal. We would be happy to answer any questions you may have.

CONNECTICUT INSURANCE DEPARTMENT

Raised Bill 764--An Act Concerning Derivative Transaction Controls

Proposed substitute language to Raised Bill 764:

Be it enacted by the Senate and House of Representatives in General Assembly convened:

Section 1. (NEW) An insurer which enters into derivative transactions as authorized by the Commissioner shall be required to include, as part of the Department of Insurance financial analysis of accounting procedures and internal controls, a statement describing the assessment by the independent certified public accountant of the internal controls relative to derivative transactions. If the internal controls relative to derivative transactions are determined to be deficient, the insurer shall require the accountant to include in the evaluation a description of such deficiencies and the insurer shall append to the evaluation a description of any remedial actions taken or proposed to be taken to correct these deficiencies, if such actions are not already described in the accountant's report.